

**NOVEMBER 2017 PROFESSIONAL EXAMINATIONS
CORPORATE STRATEGY, ETHICS & GOVERNANCE (PAPER 2.6)
CHIEF EXAMINER'S REPORT, QUESTIONS AND MARKING SCHEME**

STANDARD OF THE PAPER

The standard of the paper was good. It compares favourably with those of previous sittings. There were no ambiguities, typographical or other errors in the paper. The marks allocation was fair and marks were allocated to each sub-question. All the questions were within the scope of the syllabus.

PERFORMANCE OF THE CANDIDATES

The performance was slightly above average. There was no significant improvement in the candidate's performance. Some of the candidates performed poorly because it was evident from their scripts that they did not prepare very well for the examination.

NOTABLE STRENGTHS AND WEAKNESS OF CANDIDATES

The main strength was that almost all the candidates attempted the required number of questions. A few of them demonstrated good understanding of the subject matter. The weakness of the candidates was that some of them provided incorrect responses to questions. Another weakness is problem of transfer of learning. Some of the candidate could not do any analysis to support capital budgeting decision.

QUESTION ONE- CASE STUDY

MOBILE MONEY SERVICE

Introduction

The government of Ghana has been concerned with low savings culture, low financial inclusion as well as high cash-based transactions in the country. In the year 2005, the government decided to pursue policies to grow the financial services industry (FSI) since it was indispensable to the accelerated economic growth required to make the country middle income country. The key service providers include banks, non-bank institutions, and mobile network operators (MNOs). By the close of 2017, 52% of the population would remained excluded from any form of financial services

There is generally high cost of credit in the country as the banks complain of difficulty in mobilizing deposits. Ghana is said to have one of the highest lending rates to the world, placing second in the latest ranking released by Trading Economics, a development which has been identified as a disincentive for the business community. The government budget deficit as a percentage of Domestic Product (GDP) decreased from 8.7% in 2010 to 8.5% in 2016 respectively. In the past, the government relied on external capital markets to fund the budget deficits but, following the worsening deficit figures, international financial organisations have raised concerns about the need for the government to ensure fiscal discipline.

The major development that revolutionized the FSI was the launch of mobile money solution in 2009 by the four MNOs. Mobile money rides on the backbone of the mobile telephony infrastructure of the mobile networks operators. This allows mobile money to be operated from wherever there is network coverage. It is estimated that there is 65% mobile network coverage in Ghana.

The MNOs deliver mobile financial services largely through thousands of registered mobile money agents throughout the country. This effectively makes agents closer to the customers than traditional banks and non-bank financial institutions. Most of the traditional banks' branch networks are concentrated in the urban centres to the exclusion of peri-urban and rural communities. The combination of these two factors enables mobile money services to be administered quickly and efficiently, and in the most remote areas. The capital requirement for registration as mobile money agent is GH¢4,000 and the daily transaction limit is currently at GH¢5,000. On the average, agents operate one network mobile money, while very few agents have signed up to two or more different mobile money solutions. The total number of agents have increased from about 17,467 in 2013 to 93,376 as at close of 2016, and National Communication Authority (NCA) has projected rapid annual growth for the next three years (2017-2019).

The Environment

Mobile money started in the country largely with two products – airtime purchases and domestic remittances for small amounts. With the passage of time, mobile money service offerings have expanded to include bill payments, Point of Sales (POS) payments, fund transfers in increasingly larger amounts, and deposit collection by banks and non-bank financial institutions. The

expansion of the product offerings from mobile money makes it more appealing to a broad spectrum of mobile subscribers in the country. Customers are, therefore, keeping larger amounts in their wallets than they used to, and are using the expanding offerings from mobile money at the expense of existing products from the banks. There is growing mobile phone penetration rate as increasing number of mobile phone users are subscribing to more than one mobile network.

Furthermore, mobile money has become very popular among middle and lower income earners who make up about 80% of the population. The operation of mobile money on the handset is very easy and convenient and can be done from the comfort of one's location. All that prospective mobile money customers require are a registered SIM card on the network of choice and a valid national ID. With these they can be set up and ready to use their mobile wallets within minutes. The processes for setting up and using bank accounts are however more complex due to stricter Know Your Customer (KYC) requirement by the Central Bank. Remittances through mobile money is instant at a fee of 1% of amount remitted or received. Mobile money transactions in Ghana reached GH¢679.17 million by the end of June 2016, according to the Bank of Ghana's Payment Systems Department and it is expected to hit GH¢35 billion by the close of 2017. Until very recently, the income from mobile money was not taxed but the Minister of Finance in his 2017 mid-year review hinted of plans to impose a tax on the fees from mobile money operations.

The mobile money operations face the issue of network instability and system downtime as mobile network operators have not correspondingly expanded their infrastructure to match the growing subscribers. Sometimes, the agents are unable to meet cash demands of the customers due to mismatch in net remittances. This is more pervasive in the rural communities. Due to the weaknesses inherent in the issuance of valid Identity Cards (IDs), there are many fake ID cards and this has resulted in fraudsters having a field day. Some agents and customers have lost sums of money to fraudsters.

The customers and other players in the FSI have expressed concerns about their inability to carry out mobile money services across the various networks. Accordingly, the Central Bank has tasked its Payment Systems Department to ensure interoperability of mobile money across all networks in the country by June 2018. The government believes that mobile interoperability will deepen financial inclusion.

Regulation

Mobile money services it has operated without any regulatory framework. The industry players, according to a recent survey, suggested that the long-term survival of the mobile money service require stringent regulation. The Central Bank has now published guidelines for mobile money operators to be licensed as Dedicated Electronic Money Issuers (DEMI). The provisions include stringent KYC on the agents before registration, monthly returns on the activities of the agents, prosecution of the agents for mobile money fraud, etc. The mobile network operators are required to pay interest at the rate of 6% p.a. on the float on the mobile wallet.

Proposal

The Board of Directors of Excellent Telephone Service Ltd at a recent meeting discussed the possibility of opening a new unit to provide mobile money service to take advantage of the newly regulated industry. The Finance Director has presented a five-year estimates for the new venture as:

Year	0	1	2	3	4	5
	GH¢'000	GH¢'000	GH¢'000	GH¢'000	GH¢'000	GH¢'000
Cost of capital asset	(200)					
Total investment in net working capital	(20)	(25)	(30)	(35)	(35)	
Gross Fees		250	300	350	350	300
Direct and other costs		(155)	(185)	(215)	(215)	(195)
Depreciation		(40)	(40)	(40)	(40)	(40)
Interest		(24)	(24)	(24)	(24)	(24)
Profit		31	51	71	71	41
Net total assets	220	200	211	220	240	190

For taxation purposes, capital allowances will be available against the taxable profits of the venture, at 25% per annum on a reducing balance basis and in year 5 any balance would be granted as additional capital allowance. The rate of tax on taxable profits is 25% and tax is paid one year in arrears. The capital assets will have a zero-salvage value at the end of 5 years. The after-tax weighted average cost of capital is estimated to be 24% per annum.

Required:

- Assess **THREE** environmental factors faced by Excellence Telephone Service Ltd. (6 marks)
- Analyse the competitive environment of mobile money segment using Porter's Five Forces. (10 marks)
- Identify and explain **FOUR** critical success factors for the successful mobile money service operations (6 marks)
- Determine the viability of the project using Net Present Value (NPV) technique and advise the Board of Directors whether to invest or not. (12 marks)
- Recommend **THREE** strategies which the Board of Directors could implement to give Excellence Telephone Service Ltd a competitive edge. (6 marks)

(Total: 40 marks)

QUESTION TWO

- a) Apau Chemist Ltd is a company engaged in the manufacturing of various drugs for the local market. There have been series of ethical infractions within the company. Some top management have been accused of insider trading, bribing of some key staff of the regulatory authorities and attempts to cover up alleged distribution of expired drugs. There is total breakdown of ethical standards within the company. The board of directors have expressed grave concerns about the current happenings in the company. At its last quarterly meeting, the board resolved to engage the services of a corporate governance expert to help address the situation. The board understands that there are two major approaches to managing ethics in an organisation.

Required:

As a corporate governance expert, you have been engaged by the board to advise it on **TWO approaches to the management of ethics** in organisations. **(8 marks)**

- b) The International Federation of Accountants (IFAC) Code of Ethics discusses the need for professional accountants to be aware of and avoid conflict of interest situation as well as maintain independence in carrying out their professional duties. The professional accountant is exposed to several threats to independence, which are likely to lead to conflict of interest. A threat may arise where an assurance firm provides services other than assurance services to an assurance client.

Required:

- i) Identify the specific threat a professional accountant or assurance firm faces by providing the following services:
- Preparing accounting records and financial statements;
 - Valuation services.
- (8 marks)**
- ii) Suggest **TWO** measures each a professional accountant can take to minimize the threats identified in (i). **(4 marks)**

(Total: 20 marks)

QUESTION THREE

- a) Different organisations take different stance on corporate social responsibility (CSR), which will be reflected in how they manage such responsibilities. The stance taken normally reflects the extent of inclusion of stakeholders' interests.

Required:

Explain each of the following CSR stance:

- i) Enlightened self-interest;
- ii) Multiple stakeholder obligation. **(8 marks)**

- b) Sawaba Telco Ltd is a recently listed local company that is in the process of reorganizing its corporate governance structure to reflect its status as a public company. At the first board meeting after the listing, the board chairman raised the issue of setting up of sub-committees of the Board. The Board agreed to start with two sub committees which are Remuneration Committee and Audit Committee. The board chairman is unsure how the remuneration committee of the board should be composed, its functions and other related matters. As a corporate governance consultant, the board chairman has written to you for advice on various issues regarding the remuneration committee.

Required:

Write a report to the board chairman advising him of the following:

- i) The composition of the Remuneration Committee. **(3 marks)**
- ii) **THREE** functions of Remuneration Committee. **(3 marks)**
- iii) **THREE** factors to be considered in the remuneration of executive and non-executive directors. **(6 marks)**

(Total: 20 marks)

QUESTION FOUR

- a) Boards of Directors are expected to manage companies effectively. However, corporate boards sometimes fail to manage companies effectively. Recent corporate scandals have highlighted key weaknesses of Board of Directors.

Required:

Explain **FIVE** common weaknesses of Board of Directors. **(10 marks)**

- b) Awilo Holdings began as a small company which operated in the financial services sector of Ghana's economy. Within the last ten years, the Board, which is chaired by the founder, Ms. Abigail Kyerewaa, has incrementally expanded into three more sectors of the economy, namely: telecommunications, logistics and real estate. Currently a conglomerate, Awilo Holdings has four different companies in its portfolio and has its corporate head office located within the capital city, Accra.

Required:

Explain the different *levels of corporate strategy* as it relates to Awilo Holdings. **(6 marks)**

- c) Technology is one of the most powerful forces within the external business environment that has changed significantly how business is conducted especially within the 21st Century. For instance, information technology (IT), well exploited, can have significant impact on all the five forces of competition.

Required:

Identify **FOUR** effects of technological change on organisation. **(4 marks)**

(Total: 20 marks)

QUESTION FIVE

- a) During the past year, the management of Doncat Limited faced many challenges, including several customer complaints, loss of some key customers and a high level of employee turnover. At a meeting of the Board of Directors, the Chief Executive Officer presented a report on the financial performance of the company during the period and, in his closing remarks, he said, “Overall, we have done very well, notwithstanding the challenges we faced.” Some members of the Board were not happy with these remarks and accused him of doing a “partial evaluation” of the company.

Required:

- i) Explain **FOUR** limitations of the use of financial measures for evaluating the performance of the company. **(6 marks)**
- ii) Describe **THREE** financial measures and **THREE** non-financial measures that Doncat Limited may use to evaluate its performance. **(9 marks)**
- b) Innovation can be a major source of competitive advantage of business firms, even though it comes with a burden of cost and uncertainty. Management would have to decide whether it would be a leader or follower in the industry regarding innovation.

Required:

State **FIVE competitive advantages** associated with being a first mover in product innovation in an industry. **(5 marks)**

(Total: 20 marks)

QUESTION SIX

- a) In the business world, companies use benchmarking as a point of reference. Benchmarking occurs across all types of companies and industries. Many companies have positions or offices that are in charge of benchmarking.

Required:

- i) Explain the term *benchmarking*. (2 marks)
- ii) Explain **FOUR** advantages companies gain from benchmarking. (8 marks)
- b) Asamoah Wuudin is a Ghanaian private company owned mainly by the Wuudin family. Most of its clothing and accessories are produced and marketed by the company (some are manufactured by outside contractors). For other products, notably fragrances, cosmetics, and eyewear, Wuudin licenses its brand names to other companies. The Board of Directors of Wuudin is considering expanding into new foreign markets with *athletic clothing, hotels, and bridal shops*.

Required:

Advise Wuudin on the *most suitable foreign market entry strategy* for each of the new line of business (10 marks)

(Total: 20 marks)

SOLUTION TO QUESTIONS

QUESTION ONE

a) Assessment of the macro-environment

The case study under consideration has a number of environmental influences or variables to be considered, including the following: Economic, Legal, and social-cultural factors.

Economic Factors

There are a number of economic factors in Ghana that pose serious threats to business operations and these include:

- **High interest rates** – the interest rate regime in the country is high, second highest in the World. This means that businesses looking to raise debt capital would have to pay high cost and this can negatively affect businesses relying on debt.
- **Growing budget deficit** – the increasing budget deficit coupled with the government heavily relying on domestic money and capital markets to make up for shortfall, the government is essentially competing with the private sector for limited credit. This will crowd out the private sector and push up cost of credit and this will deprive businesses of needed capital for investment.
- Concerns raised by international financial organisations about the need for financial discipline. The government need to contain expenditure so as to reduce worsening budget deficit.

Legal

There are some issues that have legal underpinnings and these include the following factors:

- **Introduction of taxation** – the introduction of taxes on the mobile money services will obviously increase the cost of doing business. For the agents to remain profitable as before the introduction of taxes they may be forced to increase the charges on remittances.
- **Law to regulate operations of mobile money-** With the passage of new law the KYC requirements have been made stringent and this places higher burden on both the agents and operators. This to some extent is likely to limit the number of people who can do agency since if you have prior criminal record you may not be allowed to be an agent.

Socio-cultural Factors

A number of factors can be considered here:

- **Low Savings culture** – there is generally low savings culture among the citizens of the Ghana. This has implication of capital formation and deposit mobilization by the financial sector. This limits amount of credit that will be available to deficit/spending units in the country.

- **Financial Inclusion** – a sizeable number of the citizens of Ghana remained outside financial services sector. This could be one of the factors accounting for low savings culture in the country.

Technological factors

- **Inadequate technological infrastructure** – the mobile network operators have failed to match the growing subscribers and the attendant demands on the mobile infrastructure resulting in network instability as well as down time. This is impacting mobile money service negatively.
- **Innovation** - Mobile money started in the country largely with two products – airtime purchases and domestic remittances for small amounts. With the passage of time, mobile money service offerings have expanded to include bill payments, Point of Sales (POS) payments, fund transfers in increasingly larger amounts, and deposit collection by banks and non-bank financial institutions.

(2 marks for each factor discussed, Total: 6 marks)

b) Analyse the competitive environment of mobile money segment

Using the Porter’s five forces analysis include the following:

Threat of New Entrant

- **Capital requirement** – the minimum capital required by an agent is GH¢4,000 which appears to be reasonably within the reach of average Ghanaian. This may be deduced from the number of people joining as agent rising from 17,467 in 2013 to 93,376 in 2016 and projected annual rapid growth in the next 3 years.
- **New Legislation and KYC requirements** – with introduction of new legislation and KYC requirements, some people who may have questionable record may not be allowed to operate mobile money. But this may not constitute serious entry barrier since once a person does not have any criminal record he/she can pass the KYC test.
- **Switching cost**– since the mobile money appears to be standardised service and not differentiated it will not cost customers anything to switch from one agent to another hence new agents can always attract customers and will not constitute any significant entry barrier.

From the above analyses entry barriers are generally low and this will make competition much keener as more new agents join the fray.

Rivalry among existing agents

- **Number of agents** – there are large number of agents and the number is increasing and therefore competition for customers is going to be very intense all things being equal.
- **Sector/industry growth rate** – the mobile money service looks to be in growth stage. Given the number of agents joining the business one can assert that the segment is yet not at maturity or declining stage. With the potential for growth competition is likely not to be intense as compared to maturity or declining stage.

- **Pending implementation of mobile interoperability** – successful implementation of intended mobile interoperability which will allow transactions across all the four networks, this is likely to intensify the competition among the agents.
- **Standard nature of service** – the mobile money service is not differentiated in any way among the various networks. The fees charge is the same across the four networks hence this is likely to intensify competition since a customer can walk to any nearest point and get the service.
- **Low switching cost** – due to low switching cost there will be intense rivalry among mobile money providers.

Bargaining Power of Customers/Buyers

- **Self-service** – the customers are able to do a number of mobile transactions by themselves including airtime purchase, transfer from one mobile wallet to another, pay utility bills etc. The only point that mobile money agents are most needed is where a customer wants to either put money on his or her wallet or physically withdraw from the wallet. This makes customers somehow power and effectively deny agents some fees.
- **Low switching costs** – the customers really are not facing any switching costs hence mobile agents are at their mercy and can chose to transact business with any agent at any place of convenience. Perhaps to have repeated business the agents would have to do extra work to encourage customers to always return to them for business. This makes customers very powerful.
- **Access to many agents** – the number of agents are increasing and it is projected to further increase. The gives the customer many alternatives and that makes the customer bargaining power very strong.

Bargaining power of suppliers

- **Concentrated or Dominant or Few Suppliers** – the main suppliers to the agents are the four network providers. These operators are large and can dictate the terms of the relationship. The agents are very small relative to the network operators. Again, most of the fees end up with the operators. Hence the operators are very powerful.
- **There are no alternatives/substitutes** – the mobile money service was launched and is being operated by mobile network operators and are leveraging on their existing nation-wide infrastructure. There are no other companies that have nation-wide capability to deliver mobile money solution apart from the four network operators. This even makes the bargaining power of network operators very potent and veritable.
- **The agent group is not an important customer of the network operators group** – the network operators core business is voice and data which make up the substantial source of revenue. Mobile money service is just ancillary to their main lines of business. This makes the bargaining power of suppliers still very strong.

Threat of substitute products

- **Less attractive substitute services from banks** – given less stringent KYC requirements of mobile money compared to higher KYC requirements, convenience of mobile money compared to the banks, increasingly mobile money services are more attractive. This make bank services as substitute less of a threat to mobile money.
- **Low/zero switching cost for customers** – it does not cost customer to switch to mobile money for remittances and other transactions executable on the mobile money solution. This again makes banking services as substitute no threat to mobile money.

(2 marks for 2 points for each factor discussed, Total 10 marks)

c) **Critical success factors for the successful mobile money service operations**

- **Network reach** – there is currently only 65% coverage of Ghana by the network operators. For effective remittances across the whole country, there must be expansion of network to unreached areas.
- **Network stability** – stable network and zero-down time is a prerequisite for the confidence in mobile money solution. Customers may feel frustrated if the network is not stable. Network instability is one major challenge identified.
- **Product offering** – continuous expansion of services offered on mobile money will guarantee its long-term profitability and success.
- **Mobile Technology Infrastructure** – the mobile money runs on the mobile telephony technology provided by network operators without which mobile money solution would be impossible. Mobile money solution survival will depend on the survival of network operators.
- **Regulation** – to protect customer’s money and build confidence stringent regulations have been called for and that has been put in place effective 1 December 2017. This will ensure long-term survival of mobile money operations in Ghana.

(1.5 marks for each a point, Total 6 marks)

d) **Determine the viability of the project using NPV technique**

Capital Allowance Computation			
Year of Claim	Details (GH¢000)	Capital Allowance GH¢000	Tax Savings GH¢000
1	(25% of GH¢200)	50.00	12.50
2	(25% of GH¢200-50)	37.50	9.38
3	(25% of GH¢200-GH¢50-GH¢37.50)	28.13	7.03
4	(25% of GH¢200-50-37.50-28.13)	21.09	5.27
		136.72	
5	(GH¢200 - GH¢136.67)	63.28	15.82

(2 marks)

Computation of Net Present Value

METHOD 1							
Year	0	1	2	3	4	5	6
	GH¢'000	GH¢'000	GH¢'000	GH¢'000	GH¢'000	GH¢'000	GH¢'000
Gross Fees		250	300	350	350	300	
Direct cost and other costs		(155)	(185)	(215)	(215)	(195)	
Taxable profit (a)		95	115	135	135	105	
Tax @ 25% (b)			(23.75)	(28.75)	(33.75)	(33.75)	(26.25)
Add tax benefit on capital allowance (c)			12.50	9.38	7.03	5.27	15.82
Capital investment (d)	(200)	-	-	-	-	-	
Investment in working capital (e)	(20)	(5)	(5)	(5)	-	35	
Net Cash Flow (a+b+c+d+e)	(220.00)	90.00	98.75	110.63	108.28	111.52	(10.43)
Discount Factor @ 24%	1	0.8065	0.6504	0.5245	0.4230	0.3411	0.2751
Present Value	(220.00)	72.59	64.23	58.03	45.80	38.04	(2.87)
Net Present Value		55.82					

(8 marks evenly spread using ticks)

Decision:

The project will be viable as it has a positive Net Present Value of **GH¢55,820**.

(2 marks)

Alternative method for computing NPV

METHOD 2							
Year	0	1	2	3	4	5	6
	GH¢'000	GH¢'000	GH¢'000	GH¢'000	GH¢'000	GH¢'000	GH¢'000
Gross Fees		250	300	350	350	300	
Direct cost and other costs		(155)	(185)	(215)	(215)	(195)	
Capital Allowance		(50)	(38)	(28)	(21)	(63)	
Taxable profit (a)		45	78	107	114	42	-
Tax @ 25% (b)			(11.25)	(19.38)	(26.72)	(28.48)	(10.43)
Add capital allowance (c)		50.00	37.50	28.13	21.09	63.28	
Capital investment (d)	(200)	-	-	-	-	-	
Investment in working		(5)	(5)	(5)	-	35	

capital ('e)	(20)						
Net Cash Flow (a+b+c+d+e)	(220.00)	90.00	98.75	110.63	108.28	111.52	(10.43)
Discount Factor @ 24%	1	0.8065	0.6504	0.5245	0.4230	0.3411	0.2751
Present Value	(220.00)	72.59	64.23	58.03	45.80	38.04	(2.87)
Net Present Value	55.82						

e) Strategies which the Board of Directors could implement to give Excellence Telephone Service Ltd a competitive edge

- Opening more sales points or outlets.
- Giving promotional items to customers.
- Operate with all the available mobile operators.
- Embark on advertisements and publicity.

(Any 3 points for 6 marks)

(Total: 40 marks)

EXAMINER'S COMMENTS

Case Study

The assessment of the macro environment was well done. Most of the candidates were able to identify relevant factors in the macro environment and were able to explain how the factors could impact on the activities of mobile money service operators. In the case of the forces in the competitive environment, the candidates were able to identify the forces but could not explain how the forces affect mobile money service operators. Some of the candidates were not able to identify the critical success factors. There was mixed performance by the candidates in terms of determining the viability of a project using the net present value technique. The overall performance in this question was average.

QUESTION TWO

- a) There are two approaches available to the board in its effort to resolve ethical issues in Persiba Chemist Ltd. These are Compliance-based approach and integrity-based approach. Each of these approaches are discussed below:

Compliance-based approach

A compliance-based approach is basically designed to ensure that the company acts within the letter and spirit of the law, and that violations are prevented, detected and punished. Generally, organisations faced with the legal consequences of unethical behaviour take legal precautions such as the following:

- Follow laid down compliance procedure to detect misconduct on the part of any employee. The board should activate its compliance system by taking suspected employees through compliance procedures.
- Institution of audits of various contracts within the company to unravel any unethical conduct by management.
- Put in place whistleblower mechanism or systems to encourage employees to report unethical and criminal conduct/behaviour without fear of retribution
- Strict disciplinary procedures should be instituted to deal with transgressing employees.

Integrity-based approach

An integrity-based approach combines a concern for the law with an emphasis on managerial responsibility for ethical behaviour. Integrity-based approach strives to define company's guiding values, aspirations and patterns of thought and conduct. When integrated into the day-to-day operations of the organisation, it helps prevent damaging ethical lapses, while tapping into powerful human impulses for moral thought and action. The company may pursue the following strategies:

- Consciously building/inculcating ethical values and conduct into the culture of the organisation so as to become taken-for-granted assumption.
- Regular ethical based training programmes for all levels of staff in the company.
- Encouraging staff to whistle blow any unethical conduct and offering necessary protection for such staff.

Incorporating serious ethical background checks in the recruitment process in order to weed out recruitment of unethical joiners.

(4 marks for each approach, Total 8 marks)

b) The professional accountant who provides services other than assurance services for an assurance client faces **Self-Review Threat**.

i)

- **Preparing accounting records and financial statements**

There is clearly a significant risk of a self-review threat if a firm prepares accounting records and financial statements and then audits them. On the other hand auditors routinely assist management with the preparation of financial statements and give advice about accounting treatments and journal entries. Therefore, assurance firms must analyse the risks arising and put safeguards in place to ensure that the risk is at an acceptable level.

(4 marks)

- **Valuation services**

A valuation comprises the making of assumptions with regard to future developments, the application of certain methodologies and techniques, and the combination of both in order to compute a certain value, or range of values, for an asset, a liability or for a business as a whole. Audit firms should not carry out valuations on matters that will be material to the financial statements. If the valuation is for an immaterial matter, the audit firm should apply safeguards to ensure that the risk is reduced to an acceptable level.

(4 marks)

ii)

Safeguards for preparing accounting records and financial statements include:

- Using staff members other than assurance team members to carry out work
- Obtaining client approval for work undertaken.

(Any 2 points for 2 marks)

Safeguards for valuation services include:

- Second partner review
- Confirming that the client understands the valuation and the assumptions used
- Ensuring the client acknowledges responsibility for the valuation
- Using separate personnel for the valuation and the audit

(Any 2 points for 2 marks)

(Total: 20 marks)

EXAMINER'S COMMENTS

This question required the candidates to explain the two approaches to resolving ethical issues compliance-based and integrity-based approach. It also required the candidates to explain the threats faced by professional accountants who provide services other than assurance services and safeguards for preparing accounts records and financial statements and valuation of services. This question was popular and the performance was good.

QUESTION THREE

a) **Following is the discussion of the various CSR stances required.**

i) Enlightened self-interest

This stance of CSR involves with recognition of the long-term financial benefit to the shareholder of well-managed relationships with other stakeholders. The justification for social action is that it makes good business sense. An organisation's reputation is important to its long-term financial success. Given that employees see it as important that their employer acts in a socially responsible manner, a more proactive stance on social issues also helps in recruiting and retaining staff. So, like any other form of investment or promotion expenditure, corporate philanthropy or welfare provision might be regarded as sensible expenditure. The sponsorship of major sporting or arts events by companies is an example.

The avoidance of 'shady' marketing practices is also necessary to prevent the need for yet more legislation in that area. Managers here would take the view that organisations not only have responsibility to their shareholders, but also a responsibility for relationships with other stakeholders (as against responsibilities to other stakeholders). So communication with stakeholder groups is likely to be more interactive than for laissez-faire-type organisations. They may well also set up systems and policies to ensure compliance with best practice (for example, ISO 14000 certification, the protection of human rights in overseas operations, etc.) and begin to monitor their social responsibility performance. Top management may also play more of a part, at least insofar as they support the firm taking a more proactive social role.

ii) Multiple stakeholder obligations

This stance of CSR explicitly incorporates multiple stakeholder interests and expectations rather than just shareholders as influences on organisational purposes and strategies. Here the argument is that the performance of an organisation should be measured in a more pluralistic way than just through the financial bottom line. Companies in this category might retain uneconomic units to preserve jobs, avoid manufacturing or selling 'anti-social' products and be prepared to bear reductions in profitability for the social good. Some financial service organisations have also chosen to offer socially responsible investment 'products' to investors. These include only holdings in organisations that meet high standards of social responsibility in their activities.

In such organisations responsibility for CSR may be elevated to board-level appointments and structures may be set up for monitoring social performance across its global operations. Targets, often through balanced scorecards, may be built into operational aspects of business and issues of social responsibility managed proactively and in a coordinated fashion. The expectation is that such a corporate stance will, in turn, be reflected in the ethical behaviour of individuals within the firm. Organisations

in this category inevitably take longer over the development of new strategies as they are committed to wide consultation with stakeholders and with managing the difficult political trade-offs between conflicting stakeholders' expectations.

(4 marks for each stance, Total 8 marks)

b) The following are the answers to the various questions

i. Composition of Remuneration Committee

The remuneration committee should comprise of a majority of non-executive directors. The executive directors who are members of the committee should exclude themselves from deliberations concerning their own remuneration.

(3 marks)

ii. Functions of Remuneration Committee

- Establishing a formal and transparent procedure for developing policy on executive remuneration;
- Ensuring that a proper system of long term and short term compensation is in place to provide performance oriented incentives to management;
- Scrutinising executive contracts with a view to ascertaining any inordinate losses the corporate body may be liable to incur in the event of an early termination of services.

(2 marks for each point, Total 6 marks)

iii. Factors to be considered in the remuneration of executive and non-executive directors:

- **Level of experience** – the remuneration levels of directors should reflect experience and the level of responsibilities undertaken by the particular director concerned.
- **Exclusion of concerned director** - the board as a whole should determine the remuneration of non-executive directors with the individuals concerned excluding themselves from deliberations of the matter.
- **Commitment of non-executive directors** - the remuneration of non-executive directors should be fixed at a level that will ensure their commitment to the duties and obligations they are required to discharge.

(2 marks for each point, Total 6 marks)

(Total: 20 marks)

EXAMINER'S COMMENTS

This question was in two parts. The first part required explanation of corporate social responsibility stances – Enlightened self-interest, multiple stakeholder obligations. The second part was a test on the composition of Remuneration Committee, functions of Remuneration Committee and factors to be considered in determining the remuneration of executive and non-executive directors.

The candidates did well on the composition and functions of Remuneration Committee but performed poorly in the rest of the questions- that is, corporate social responsibility stances and factors to be considered in the directors' remuneration.

QUESTION FOUR

a) Common failures of Board of Directors

- **Domination by a single individual**

A feature of many corporate governance scandals has been boards dominated by a single senior executive with other board members merely acting as a rubber stamp. Sometimes individual may by pass the board to action their own interests. Even if an organisation is not dominated by a single individual, there may be other weaknesses. The organisation may be run by a small group centred round the chief executive and chief finance officer, and appointments may be made by personal recommendation rather than a formal objective process.

- **Lack of involvement of board**

Boards that do not meet regularly or that fail to systematically consider the activities and risks of an organisation are clearly weak. Sometimes the failure to carry out proper oversight is due to a lack of information being provided, or the directors lacking the knowledge or skills necessary to contribute effectively.

- **Lack of supervision**

Employees who are not properly supervised by the board can create large losses for the organisation through their own incompetence, negligence or fraudulent activity.

- **Poor oversight of accounts and audit**

A lot of governance guidance has been concerned with defining effective internal control. Inevitably, many companies involved in scandals have had glaring weaknesses in internal control, weaknesses that have not been picked up by those monitoring control.

- **Lack of adequate control function**

An obvious weakness is a lack of internal audit. Another important weakness is lack of adequate technical knowledge in key roles, for example in the audit committee or in senior compliance positions. A rapid turnover of staff involved in accounting or control may suggest inadequate resourcing, and will make control more difficult because of lack of continuity.

- **Misleading accounts and information**

Often misleading figures are symptomatic of other problems but clearly poor quality accounting information is a major problem if markets are trying to make a fair assessment of the company's value.

The ultimate risk is of the organisation making such large losses that bankruptcy becomes inevitable. The organisation may also be closed down as a result of serious regulatory breaches, for example, by misapplying investors' monies.

(Any 5 points for 10 marks)

b) **The different levels of strategic management as it relates to Awilo Holdings are as follows:**

- **Corporate level of strategy**

At the apex level of strategic management in Awilo Holdings is the corporate head office located in Accra. The corporate level of strategy, which is the responsibility of the board of directors of Awilo Holdings, is concerned with the overall purpose and scope of the organisation and how value will be added to the different strategic business units.

In Awilo, strategy and strategic management at the corporate level is expected to impact upon the whole organisation. Thus, all parts of the business operation should support and further the strategic plan. Specifically, the board of Awilo has the sole responsibility of determining which industries to involve the organisation. It is also expected that the board of Awilo will prioritize and manage the expectations of stakeholders. Finally at the corporate level, the board is expected to allocate or obtain corporate resources both for the present and the future.

- **Business-level strategy**

Business level strategy represents the second tier level of strategic management. In Awilo Holdings, business level strategy would refer to each of the particular and distinct combination of products and markets dealt with by each strategic business unit – in this case the individual firms that operate in the different sectors aforementioned. It is the responsibility of each of the corporate managers to translate the statements of direction and intent generated at the corporate level into concrete objectives and strategies for their respective business units. In essence, the corporate managers of each business unit determine how their respective firms will compete in the product-market arena.

- **Functional or operational level strategy**

This level is concerned with how the components parts of an organisation deliver effectively the corporate and business level strategies in terms of resources, processes

and people. The functional level represents the third tier or the bottom of the decision-making hierarchy. The functional level in Awilo Holdings will be the operational areas for each of the business units such as Finance and accounting, human resource, marketing and sales, research and development functions. The managers at the functional areas are to develop annual objectives and short-term strategies that would implement the strategic plans of their respective business units. The focus of functional level managers is to do things right – i.e. be efficient.

[3 points @ 2 marks each = 6 marks]

c) Effects of technological change on organisations

- **The type of products or services that are made and sold.**
- The way in which **products are made** (eg process automation, new raw materials)
- The way in which goods and services are sold. The growth of direct selling via the internet has had a significant impact on the implementation of business strategy
- **The way in which markets are identified.** Database systems make it much easier to analyse the market place.
- **The way in which firms are managed.** IT encourages delayering of organisational hierarchies, homeworking, and better communication. Technology has also enabled greater integration between buyers and suppliers via the use of Extranets.
- **The means and extent of communications with external clients.** The financial sector is rapidly becoming electronic - call centres are now essential to stay in business, online banking is becoming increasingly common, and the internet, smart phones and tablets are featuring in business plans.

(Any 4 points for 4 marks)

(Total: 20 marks)

EXAMINER'S COMMENTS

The focus of this question was on common failures of Board of Directors, levels of strategic management, and the effects of technological change on organizations. The candidates provided good answers on the common failures of Board of Directors as well as the levels of strategic management. However, a good number of the candidates were not able to explain the effects of technological changes on organizations.

QUESTION FIVE

a) i. **Limitations of Financial Measures**

- Financial analysis often measures past performance only and does not show what is happening currently.
- It involves subjective judgments e.g. Positive or negative values or low and high values may mean different things for different industries or even organization.
- Financial analysis also only talks about the financial health of the organization and not every aspect of its performance.
- Comparing any two years may not reveal the true picture i.e. especially good or especially bad is unlikely to be repeated.

(4 points well-explained @ 1.5 marks = 6 marks)

a) ii. In evaluating the performance of an organization the following measures may be employed

Financial

- **Return on Capital Employed (ROCE)**

ROCE is used by companies to assess the value add by investing a certain amount of capital. It aims at ensuring the efficient use of capital. It is expressed as a percentage of profit earned over the capital employed.

- **Economic Value Added**

Economic Value Added (EVA) is used to assess ongoing performance of the organization. It helps managers to determine whether current policies are creating value. It is used to assess the company's current position in terms of the value that has been created by the past and current strategies being employed. Basically, if a company achieves a positive EVA then the investment will have generated a surplus greater than the firm's weighted average cost of capital and therefore created value for the shareholders. $EVA = \text{Adjusted profits after tax} - (\text{adjusted capital}) \times \text{weighted av. Cost}$

- **Pay back**

Payback simply measures the number of years it will take to recover the original investment from net cash flows resulting from a project. Typically, it is used to make an investment decision that requires a choice between two or more projects. If the payback is the sole evaluation criterion, the company would choose the option which would result in the shortest payback period.

- **Net Present Value**

This approach is used to calculate the present value of projects. It is based on the principle that money received today is worth more than money received net year because of the opportunity to invest and consequently earn a return. There are three possible outcomes: where BPV is 0, there decision maker is indifferent. NPV is negative: The project will fail to generate sufficient funds to cover the cost of capital. NPV is positive: the project is likely to generate a return greater than the cost of capital. An investment may be considered.

- **Ratios (profit, sales, operational)**

There are three main types of ratios: Profit ratios, Sales ratios and Operational ratios. Thus, ratios are used to measure profits, sales performance and the organizations ability to generate cash.

Profit ratios: The main profit ratio is the profit margin which measures the amount of profit generated form sales. ie. Profit before interest + tax divided by sales turnover. Other profit ratios include profit generated from the use of assets (profit/net assets), gross profit generated from sales (gross profit/sales) and net profit generated from sales (net profit/sales)

Sales Ratios: The main sales ratio is asset turnover ie sales/net assets. Other ratios used by firms involve sales turnover calculated as a ratio of: fixed assets, working capital or selling cost. All these ratios either tracked over time or compared against competitors or the standards set can give a company a measure of the efficiency of their performance in these areas.

Operational Ratios: Operational ratios help a company assess its ability to generate cash on which to run the business. Without cash a company cannot operate its business, therefore the liquidity of the company and its amount of working capital will be regularly monitored. In these ratios the turnover periods in which cash will be generated are calculated, usually expressed in terms of days or how many times the business is exchanging cash.

The main liquidity ratios are: Debt collection period: level of debt/sales turn over, Stock turnover period: average stock level/ total cost of goods, sold Creditors turnover period: average trade credit/ cost of sales Current ratio: current assets/current liabilities. Any increase in any of these ratios will warn the company that cash is being tied up in funding the work in progress.

(3 points well-described @ 1.5 marks =4.5 marks)

Non - Financial Measures

There are many non- financial measures and the choice of an appropriate measure depends on the critical success factors that drive performance in the

market/industry. Thus, if a critical success factor is superior customer value, level of customer satisfaction and level of customer loyalty may be key measures. Some of the common non – financial measures are:

- **Market share** – measures the percentage of the total market that an organization controls. A high market share indicates that the organization occupies a relatively high market position as compared to the others.
- **Sales volume/ growth** – a high sales volume suggests that the organization is doing well in terms of sales.
- **Customer loyalty** – demonstrates the extent to which customers are willing to continue buying the organisation’s product/service. This reflects the quality of product/service and customer service provided by the organization.
- **Number of customer complaints** – many customer complaints signify weak performance with regard to product/service quality, access to the products/services or challenges with the processes that customers have to go through.
- **Market image and awareness levels** – the image of the organization or product and level of awareness signifies the effectiveness of the organisation’s promotional efforts and level of acceptance and usage of the product/service.
- **Employee motivation** – the extent to which employees are willing to put in more efforts in their performance is an indication of how well the organization is treating them.
- **Employee turnover** – measures of employee turnover (the rate at which employees leave the organization) signify the level of their satisfaction with conditions in the organization.

(3 points @ 1.5 marks= 4.5 marks)

b) Competitive advantages that may be associated with being a first mover in product innovation in an industry are as follows:

- A reputation for innovation will attract early adopters, though it depends in part on promotional efforts by the firm.
- Customers may find that they are locked in to innovative suppliers by unacceptable costs of switching to rival firms.
- The learning (or experience) curve effect may bring cost advantages to the innovative firm.
- The first mover firm may be able to define industry standards.
- A price skimming strategy can bring early profits that will be denied to later entrants.
- Legal protection, such as patents, for intellectual property may bring important revenue advantages.

(5 points @ 1 mark each = 5 marks)

(Total: 20 marks)

EXAMINER'S COMMENTS

The areas tested in this question were limitation of financial measures, competitive advantage for first mover in product innovation in an industry, financial measures and non-financial measures. The candidates did well by explaining financial measures but struggled with explanation non-financial measures and limitations of financial measures. A few of them could also not explain the advantages of first mover in product innovation.

QUESTION SIX

a)

i) **Benchmarking** is the process of gathering data about targets and comparators that permit current levels of performance to be identified and evaluated against best practice. Adoption of identified best practices should improve performance.

(2 marks)

ii) **Benchmarking has the following advantages:**

- Position audit. Benchmarking can assess a firm's existing position, and provide a basis for establishing standards of performance
- The comparisons are carried out by the managers who have the live with any changes implemented as a result of the exercise.
- Benchmarking focuses on improvement of key areas and sets targets which are challenging but evidently achievable.
- The sharing of information can be a spur to innovation.
- The result should be improved performance, particularly in cost control and delivering value.

(2 marks each for any 4 points = 8 marks)

b) **In choosing between the most suitable market entry strategy, the key criteria is likely to be:**

The opportunities for sharing or transferring Wuudin's other resources and capabilities with/to the new businesses: Apart from its brand, which of Armani's other resources and capabilities can be utilized in the new business?

(1 mark)

In-House

In the case of **bridal clothing and accessories**, Wuudin can probably utilize its existing design, manufacturing, marketing, and distribution capabilities – in which case Armani can develop this business in-house.

(3 marks)

Joint Venture

In the case of athletic clothing and equipment, Wuudin may need to access the technical capabilities needed to design products for different sports – hence, a joint venture may be appropriate. **(3 marks)**

Licensing

In the case of hotel management, it is not apparent that any of Wuudin’s resources and capabilities (other than its brand) relate to the design and operation of luxury hotels – hence, licensing may be the best solution. **(3 marks)**

(Total: 20 marks)

EXAMINER’S COMMENTS

In this question, the candidates were required to explain benchmarking and its advantages. They were also required to explain suitable market entry strategies with key criteria for the selection of a particular strategy. Not many candidates answered this question, the few who answered it did well in the first part but performed poorly in the second part. Perhaps, this was due to the scenario type of question in the second part.